

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE

SAN FRANCISCO, CA 94102-3298



May 24, 2005

James Mayer

Executive Director

Little Hoover Commission

925 L Street, Suite 805

Sacramento, CA 95814

Comments of the California Public Utilities Commission (PUC) on the Governor's Energy Re-Organization Proposal

Dear Mr. Mayer:

Thank you for the opportunity to submit comments on the Energy Re-Organization proposal. As noted in our comments, we commend the Governor's goal of reorganizing California's energy agencies to facilitate development of a clear energy policy direction for California. We support the major goals of the reorganization plan, particularly those that build on and continue the implementation of the Energy Action Plan that the energy agencies have successfully worked together to implement over the past two years.

However, despite our support for the overarching reorganization objectives, we have reservations about some components of the proposal and we also are concerned about a number of unanswered questions that arise from the explanatory materials that have been presented to the Little Hoover Commission.

We view these comments as the beginning of an informed dialogue between the CPUC, the Administration, your Commission, and other stakeholders as to how to best structure California's energy policy. Recognizing the tight statutory timeframe under which you must operate, please feel free to contact us as needed for any information or resources that you may need as you conduct your review.

I look forward to seeing you on the 25th and being able to answer any questions that you may have.

Sincerely,

//original signed by Steve Larson//

Steve Larson

Executive Director

Cc: Commissioners

**Comments of the California Public Utilities Commission
on the Governor's Vision for California's Energy Future**

**Provided to the Little Hoover Commission
by Steve Larson, Executive Director**

May 24, 2005

Summary

The California Public Utilities Commission (PUC) commends the Governor's goal of reorganizing California's energy agencies to facilitate development of a clear energy policy direction, reduce bureaucracy and duplication, and enhance public access and transparency. The proliferation of energy agencies as part of electricity deregulation contributed to a perception that the state's energy policy is fragmented and uncertain, and this proposal is designed to overcome that perception. We support the major goals of the reorganization plan (Plan), particularly those that build on and continue the implementation of the Energy Action Plan that the energy agencies drafted, adopted, and have successfully worked together to implement over the past two years.

Despite our support for the overarching reorganization objectives, however, we have serious reservations about some components of the proposal. We also are concerned about a number of unanswered questions that arise from the explanatory materials that have been presented to the Little Hoover Commission.

Before reflecting on the details of the proposal, we want to focus candidly on a goal that is central to the entire purpose of reorganization, namely, to provide a comprehensive, cohesive and complete energy policy for California. Regrettably, this end cannot be achieved in its entirety because the Plan does not include the municipally-owned utilities in California, although they provide energy to 25% of the state's population. These utilities make most of their energy decisions, including whether or not to participate in the Renewable Portfolio Standard, outside the statewide planning rubric for investor-owned energy utilities. In California there are three planning territories: the investor-owned utility service areas regulated by the PUC, the ISO-controlled transmission system with some (but not the largest) municipally-owned utilities, and the individual

municipally-owned utility systems themselves. This gap has been noted for many years in many forums, but we would be derelict in not mentioning it again in the context of a reorganization plan that seeks to consolidate planning and permitting of needed energy infrastructure.

The PUC's reaction to this plan is necessarily still in a formative stage as we received materials at the same time that they were delivered to the Little Hoover Commission. Our initial reaction was to wonder why, with interagency collaboration at an all-time high, a major reorganization was urgently needed now. We perceive many successes from the current collaboration. Our ongoing efforts effectively merge policy development capabilities of both the Energy Commission (CEC) and PUC, and have resulted in the expedited implementation of the Renewable Portfolio Standard, measurable accelerated progress on resource adequacy, improved statewide transmission planning, and aggressive and clearly-defined energy efficiency goals and program implementation. In an unprecedented move, policymakers of the agencies have met jointly every quarter to reinforce their common adopted vision and to measure progress toward goals. Nevertheless, we respect the right and ability of the Administration to formally consolidate programmatic functions and staff to more clearly speak on behalf of the state in the area of energy policy.

With regard to the proposed reorganization's impacts on the PUC, we have a fundamental concern about how the "purse strings" can be divorced from the policy making functions. The core function of the PUC as the economic regulator of the State's investor-owned utilities has not changed in nearly 100 years. Historic policy and market developments such as deregulation and increasing Federal Energy Regulatory Commission (FERC) jurisdiction prompted the creation of other agencies but did not diminish the PUC's role in overseeing and adjudicating the activities of the privately-owned energy utilities whose annual revenues are \$25 billion. The PUC has remained in charge of the utilities' revenues, costs and rates, acting in the public interest as directed by the State Constitution and legislation. The potential detrimental impact of decoupling this relationship is one of the PUC's key overall concerns about the proposed reorganization.

The PUC's more specific reservations and questions about the Plan are as follows:

- **What is the intended benefit of the proposed transfer of authority over transmission and natural gas infrastructure siting from the PUC to the proposed Department of Energy (DOE)?**

While the issue of agency authority over transmission siting has been a subject of extensive debate and ongoing interagency collaboration within California over the past years, the issue of natural gas siting authority has not previously been discussed among the agencies. Transfer of these functions will require extensive interagency staff and legal work to develop detailed implementation plans.

- **What is the desired effect of establishing an Office of Market Oversight?**

On the basis of the materials provided to the Little Hoover Commission, it appeared that this office would assume "exclusive" representation responsibility of "ratepayer interests" before FERC and would involve the transfer of FERC representation from the PUC to the proposed DOE. Subsequent discussions with the Administration have clarified that the intent of the Plan is to transfer to the DOE only the existing functions of the Electricity Oversight Board, not to remove or supplant any of the functions currently undertaken by the PUC. As a result, our comments on this issue are more narrowly focused than would otherwise be the case.

- **What is the intent of the Plan with respect to a number of policy-driven programs currently overseen by the PUC?**

Right now, in close collaboration with the CEC, the PUC oversees the following:

- Over \$500 million per year in electricity and natural gas energy efficiency programs;
- Over \$125 million per year in incentives for clean and renewable distributed generation;
- Approximately \$40 million per year in natural gas research and development programs;
- Approximately \$50 million per year in demand response programs designed to encourage customers to reduce their electricity demand at peak times; and

- The Renewable Portfolio Standard Program which will require major investments in infrastructure and commitments to purchase renewable energy by the investor-owned utilities in order to attain the goal of 20% by 2017.

All of these programs are consistent with the Energy Action Plan loading order and are key components of achieving those policies that the agencies collectively endorse. The Plan does not explicitly mention reassignment of oversight for these programs, but with the proposal that the new DOE set all overall policy, we are concerned about the disposition of these vital programs for which the PUC currently is the primary policy-setting body.

The short timeframe for submittal of these comments did not allow for formal consideration by the full Commission. However, within these time constraints and the bounds of the Bagley-Keene Open Meeting Law, we have worked with Commissioners and staff to attempt to develop informed views on the issues of support and concern. This item will be reported on at the PUC's formal business meeting on May 26.

In responding to the Little Hoover Commission, we have further organized our comments around the three questions posed in your May 16 letter to the PUC.

- **Question 1: What are the State's greatest challenges in developing a cohesive energy policy? How does the State's organizational structure impede or enable the resolution of those challenges?**

One of California's greatest challenges is conducting meaningful statewide planning and implementing energy policies that will allow us to move beyond the crisis mode of the past and re-institute long-term planning and procurement to ensure reliable, reasonably priced energy from safe and environmentally benign resources. In hindsight, the rush to create new laws and governmental entities to react to the energy crisis was understandable. However, this created a new set of challenges as California sought to regain its leadership to address increasingly complex state, federal, and global energy issues.

To address this challenge, the PUC has worked actively and with success to pursue coordinated action within the existing agency structure. In 2003 the PUC was a leader in developing a coordinated, proactive, state energy policy with the CEC and the Power Authority (CPA) to produce the well-received 2003 Energy Action Plan.

The PUC has continued to work actively with the other energy agencies to implement the Energy Action Plan. Those efforts have paid off in the widespread acceptance of the Plan's loading order for energy resources which prioritizes conservation and efficiency before all other options. Agency coordination to implement the Energy Action Plan also has resulted in shared policy direction and enhanced implementation.

Each agency brings unique and important perspectives and skills to bear on issues, whether it is to ensure affordable, reliable and safe energy services, provide research and development expertise, establish and manage the activities of market participants, or to ensure that environmental requirements are met. Having this variety ensures that the policy making process will incorporate many perspectives. The PUC has sought to engage with our sister agencies on the issues where our missions touch or overlap in order to identify and eliminate fragmentation or redundancy, and as a result, there is more coordination and greater cooperation among the agencies than ever before. As mentioned previously, a significant gap in the ability of the state agencies to establish and implement statewide policies is the omission of the municipally-owned utilities.

The greatest challenges arise when processes become uncertain or transparency among the agencies is hampered and reduced. Our detailed comments about the Administration's proposed Plan identify specific areas of concern that would need to be addressed in the development of the Plan's implementation details.

- **Question 2: Does the Governor's proposed reorganization plan solve these structural deficiencies? Does the plan create any new challenges for developing and implementing a cohesive energy policy?**

The Administration's Plan seeks to build on and supplement the energy agencies' ongoing level of cooperation. In general, the PUC believes that the Plan is on the right track

in its attempt to clarify agency roles and to stress the importance of statewide, integrated energy planning through the Integrated Energy Policy Report at the new DOE. We support the creation of a DOE, and the consolidation of the CEC, Electricity Oversight Board (EOB) and the CPA into the new Department. These elements of the Plan are designed to:

- Acknowledge the importance of energy to California's economy and its connection to the Western region by elevating focus on important energy issues to Cabinet-level status,
- Develop a single agency coordinator for strategic energy policy for California,
- Institutionalize and expand the effective agency relationships established in the Energy Action Plan, and
- Recognize the expertise and legal responsibility of the PUC to protect consumers, establish rates, and ensure adequate infrastructure for delivery of services to the investor-owned utility customers.

Because some of the changes being proposed are new ideas and broad in nature, we have serious concerns about the details of implementation. In an effort to streamline, some important agency roles may have been reduced or eliminated and may produce unintended consequences.

Reorganization Issue: Transfer of the PUC's siting authority over electric transmission infrastructure

Background Information on the Current Transmission Siting Process: The transmission siting and approval process is highly technical and complex from any perspective. Because so few people understand it, we provide a very brief description of the three different functions that must be considered in transmission planning in California. They are:

- Engineering and inter-connection issues
- Economic costs and benefits
- Environmental effects and mitigation

The engineering function focuses on technically ascertaining that there is a need for a new or upgraded transmission line in a particular corridor in order to improve system reliability, reduce congestion, improve the ability to move electricity from where it is generated to where is consumed, and facilitate new generation sources. This technical

function is performed in California by the ISO for lines within its control area, and by municipally-owned utilities for lines within their control areas. The ISO has a statewide perspective, as most of the power in the state – to and from various load serving entities including utilities, electric service providers, and some municipally-owned utilities -- flows through its control area. While it is possible for a public or private entity to propose to build or upgrade a transmission line without ISO approval, such entities are much better off seeking the ISO's imprimatur.

A second transmission planning function is economic – the determination of whether the transmission owner, the load-serving entity and end-use customers are better off if the transmission line is built or upgraded. This function is currently handled in different ways. A private entity seeking to construct a merchant transmission line must perform its own economic analysis, and its shareholders should take on all of the risk and reward aspects of that decision. A municipally-owned utility faces the same situation, performing the economic analysis on behalf of its constituents. A public utility regulated by the PUC must apply for a Certificate of Public Convenience and Necessity (CPCN). The CPCN process involves:

- review of the need for the project,
- review of the economic costs and benefits of the project, and
- environmental review.

The ISO is well-positioned to take the broad view on the engineering need for transmission projects. The PUC's current practice is to accept the ISO's engineering determination of need for the project. The PUC's review of the costs and benefits of the project is intended to determine whether the proposal is in the interest of public utility ratepayers. For example, the PUC may impose a cost cap on the utility. If a CPCN is granted by the PUC, the utility seeks approval from FERC to put the costs into a wholesale transmission tariff to be included in retail rates. The ultimate rate design is performed by the PUC.

A third transmission planning regulatory function is the environmental review, also known as siting, whereby a regulator determines the environmental impact of the proposal and proposes any necessary mitigation measures. As with the economic review, this function is performed by different entities in different circumstances. If the new construction or upgrade is part of a federal interstate project, an appropriate federal agency performs the environmental review (although this review may also be jointly performed by a federal agency and a California regulatory body). If the proposing entity is a municipally-owned utility, the municipally-owned utility performs its own environmental review. If the proposed project is located entirely within California – but is not a public utility-sponsored project-- the review is performed by a regulatory agency other than the PUC (the lead agency on the Path 15 upgrade project was the Western Area Power Administration, a federal agency). If the proposal is a public utility project, the environmental review is performed by the PUC as part of the CPCN application (this review may also involve other California entities acting as responsible agencies under CEQA).

Changes Proposed in the Plan: The new DOE would perform the permitting functions for all transmission lines and sub-transmission lines (down to the 50 kV level) of the investor-owned utilities and the PUC would continue to have exclusive responsibility over the utilities’ retail rates. While the Plan would consolidate generation permitting with some aspects of transmission permitting, there would still be permitting requirements at the state and local levels. The PUC also would still be responsible for much of the siting for generation, including all non-thermal utility projects (e.g., hydroelectric) and for any utility projects located out of state, such as the Mohave coal facility.

In addition, just as today, no agency of the State would have authority over transmission infrastructure decisions of either municipally owned utilities or federal agencies.

PUC Concerns: The Plan cites lack of clear responsibility “. . . to see that new power plants and transmission lines get built.” It also cites inconsistent analyses and inadequate

consideration of regional and statewide benefits. But it is not at all clear how the proposed transfer of permitting authority would ensure that needed energy infrastructure is coordinated with utility procurement priorities and with the necessary financing approvals from the PUC so that projects requiring investor-owned utility participation can be built without unneeded delay.

Under current statutes, the PUC is the only entity in California that can clearly consider the economic impacts of projects on public utility ratepayers and advocate for the State of California at FERC and elsewhere with regard to similar federal projects. The PUC has significant expertise in this area, and ratemaking is a core function and core competency of the PUC. The PUC is also able to consider the economics of these transmission projects in view of other utility generation and distribution projects, as part of an integrated resource planning perspective. The PUC's economic review of these large projects can inform the proposed DOE in its broader review of state energy policy. For smaller public utility transmission projects with more local impacts, the PUC is also the natural locus for economic review, but these projects would be transferred under the proposed Plan.

The PUC's current transmission line siting jurisdiction also helps ensure adequate transmission to deliver the renewable power needed to meet the State's RPS goals as incorporated by the PUC in its review of utility procurement plans.

Another concern is how the DOE would consider the economic impacts of projects on ratepayers in view of other utility generation and distribution projects as part of an integrated resource planning and ratemaking perspective. The PUC's mission is to assure California utility customers have safe, reliable utility service at reasonable rates, to protect utility customers from fraud, and to promote the health of California's economy. The integration of the elements of transmission siting relevant to the PUC's mission is as yet undefined in the Plan.

For these reasons, and because the critical implementation details are not yet defined, the PUC does not support the transfer of siting authority over electric transmission infrastructure to the proposed DOE. We look forward to further clarification in the legislative draft that will resolve this matter.

Reorganization Issue: Transfer of Natural Gas Infrastructure Authority and Storage Certification

Changes Proposed in the Plan: The Plan appears to remove all PUC authority over permitting for natural gas facilities and transfers authority over gas infrastructure siting to the DOE. In recent discussions, the Administration has stated that the intent is to separate transmission from distribution and to leave in place current PUC authority over gas distribution.

PUC Concerns: As with the transfer of electric transmission siting authority, the PUC's concern about this aspect of the Plan is how it would retain an integrated planning process and avoid creating a barrier to timely and effective decision making relative to natural gas infrastructure. Under the current system, the PUC is responsible for utility infrastructure development, coordinating its work with the work at FERC on interstate and intrastate issues. The current arrangement enables the PUC to evaluate ratepayer impacts and respond to them. The Plan appears to remove the PUC's authority to certify gas infrastructure in advance, creating a process whereby the PUC will be involved only on an "after the fact basis" on what the ratepayer impact will be and this creates an untenable situation from a regulatory perspective.

Under state and federal law, the PUC is charged with responsibility to enforce safety regulations for gas facilities under its jurisdiction and it has the authority to set even stricter safety standards than federal regulations. Transfer of siting authority from the PUC could easily jeopardize the State of California's right to regulate the safety of natural gas pipelines and LNG facilities.

Another PUC concern about this proposed transfer has to do with the current ability of the PUC to identify need and to direct and require utilities to provide appropriate

solutions, including gas infrastructure. As part of its obligation to ensure safe, reliable, low-cost gas service, the PUC periodically re-examines the structure, rule, practices and facilities of the natural gas utilities. This process generally includes a determination of the adequacy of backbone pipeline capacity and storage facilities and can lead to the creation of rules establishing the extent to which the utilities must maintain slack gas transmission capacity. The PUC has the authority, based on this type of investigation, to direct a utility to extend, repair, improve existing facilities, or to erect new facilities. No other agency has this critical authority, and we are concerned that it will be lost under the proposed reorganization.

The PUC also is concerned about the potential impact of the Plan on pending litigation at FERC. This is an issue that requires more time to analyze. For these reasons, and because the critical implementation details are not yet defined, the PUC does not support the transfer of authority over natural gas infrastructure to the proposed DOE until the proposed implementing legislation is clarified.

Reorganization Issue: The Proposed Office of Market Oversight and Its Role before FERC

The PUC has historically represented California's interests before FERC due to the need to coordinate ratemaking and rate design issues on the federal wholesale and state retail levels. FERC is responsible for wholesale energy and transmission rates, and the PUC is responsible for retail rates. There is a clear link between energy costs considered by FERC and the costs paid by California ratepayers. With certain exceptions, under the federal Filed Rate Doctrine, any FERC-approved costs are passed on by the PUC to retail customers. The PUC currently is able to challenge energy costs approved by FERC as they will have direct impacts on the retail rates paid by California consumers.

FERC gives state utility regulatory agencies enhanced standing in proceedings before FERC through special provisions in federal statutes, and FERC Commissioners and PUC Commissioners have established strong working relationships. Having the PUC set the

rules under which the utilities operate at both the federal and state level historically has minimized duplication and reduced costs: the PUC oversees the utilities' purchases of electricity and natural gas through a combination of long-term and shorter-term purchases from energy markets and is able to integrate electric and natural gas issues and rates in representation before FERC. Active and continuous PUC representation before FERC also historically has helped clarify the sometimes unclear boundaries between what is federal and state jurisdiction. The PUC has the same exact role for telecommunications (at the Federal Communications Commission), and transportation utilities (at the Federal Railroad Administration) with a long record of successful advocacy on behalf of the people of California.

The PUC's record of successful advocacy before FERC includes:

- \$1 billion in refunds in the El Paso Natural Gas settlement
- Multi-million dollar reductions in transmission and electric reliability costs that otherwise would have been passed on to California consumers
- Working with the EOB and the Attorney General, additional multi-million dollar refunds from settlement of claims arising from the energy crisis

This core expertise and experience must continue at the PUC independent of the creation of a new Office of Market Oversight, and it is our understanding that the Administration intends for that to be the case. Nevertheless, the Plan currently is written in a way that describes another interpretation. We are very concerned that creation of the Office of Market Oversight may lead to duplication, fragmentation, or the potential weakening of what has been acknowledged at the state and national levels to be a strong "safety net" of protections provided by the PUC against market power abuse by utilities.

- **Question 3: What impact might the new organizational structure have on the price and reliability of energy in the state? How will the structure affect the ability of the Public Utilities Commission to ensure that Californians have reliability, affordable and safe energy?**

It is impossible to assess the effect the proposed Plan would have on the price of energy in California because the details of implementation are not developed. Improved policy

coordination and consolidation of organizational functions could result in lower administrative costs; duplication of responsibilities obviously would not.

As noted in our comments, implementation of the Plan as outlined potentially could have an effect on the PUC's ability to ensure reliable and safe energy by transferring current functions to an agency that ***will not have the clear authority to require utilities to take actions that may be needed for reliability and safety purposes.*** Without the "power of the purse" it may be extremely difficult to enforce utility actions that are deemed necessary by the state. However, it is impossible to evaluate the real impact until details of the proposed reorganization are developed and can be carefully evaluated

Conclusion

Consideration of the proposed reorganization framework is important and is the issue immediately before the Little Hoover Commission. However the real work of defining the genuine current problems and their likely solutions has yet to be undertaken. The Plan is a general description of organizational intent. Before that intent can be realized, an intense effort must be mounted to clarify what statutory authorization will be needed to effectively integrate agency functions without creating new problems in the process. The PUC is committed to working cooperatively with the Administration to assure that the details are fully explored and captured appropriately.

